DOW THEORY LETTERS INC.

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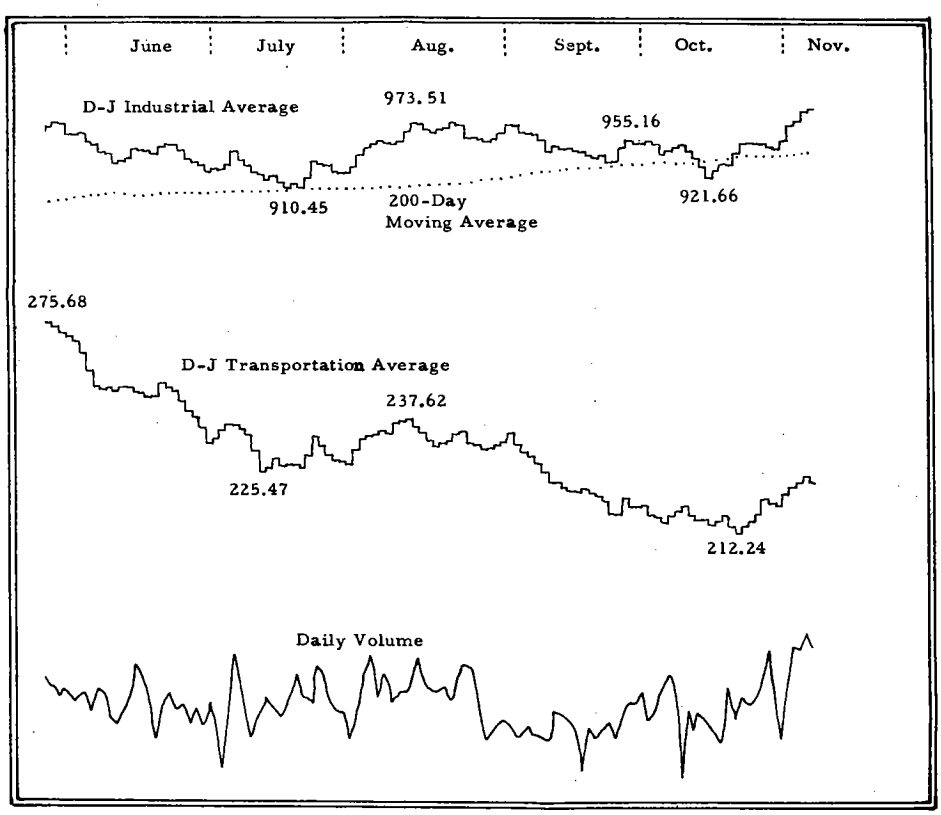
Oct. 27, Dow 946.42, PTI 923, A-D ratio -3.79
Nov. 3, Dow 984.12, PTI 947, A-D ratio -2.76

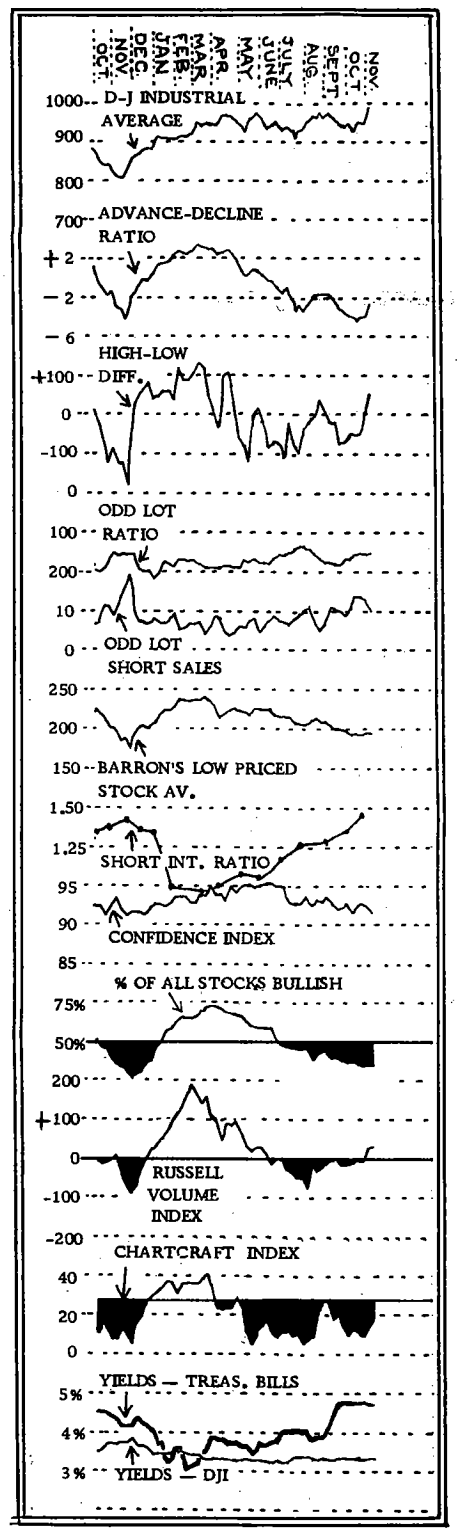
THE MARKET: It's all over; President Nixon has won a resounding victory, and the nation is in his hands for another four years (of course, Congress may also enter the picture somewhere along the line, although I realize that's asking alot). The same problems that accompanied Mr. Nixon's first term are there in spades as he begins his second term. The only problem which has actually been eliminated is Senator George McGovern.

Turning to Wall Street, on Friday, November 3, the Dow Industrials spurted up to close at 984.12, a new 1972 recovery high. As seen on the page 2 chart, the November 3 closing represented the fifth distinct ascending peak for the Dow, measured against an equally distinct series of five descending peaks for the advance-decline ratio. In the entire history of the relationship between the Dow and the A-D ratio, there has never been such a flagrant, massive and extended series of divergences. The divergences of 1959, 1961, 1965, 1968, they all pale when compared with the current 1972 phenomenon.

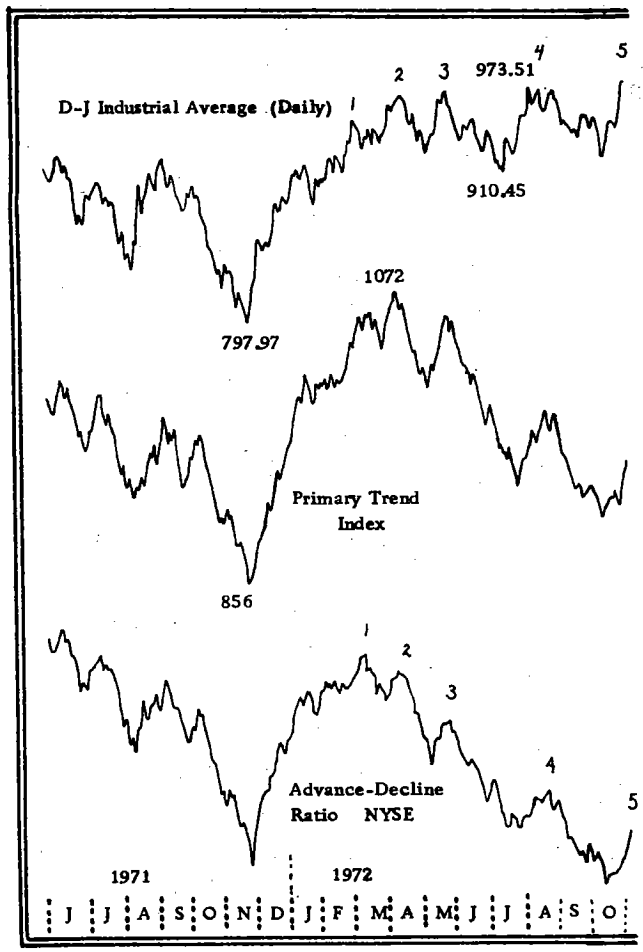
From the standpoint of the Primary Trend Index (see page 2 chart), the "out-of-gear" action is almost as outstanding, except that here the divergence starts at the April peak instead of March (as was the case with the A-D ratio).

Finally, from the standpoint of Dow Theory, the relative positions of the Industrial and Transportation Averages as seen on the chart on this page is hardly a picture of "togetherness." The question is, what does it mean? Robert Rhea, the great Dow Theorist of the 1930's, believed that persistent divergence indicated distribution under





the guise of "strength" in one Average or the other. I am inclined to agree. The fact is that many periods of divergent action in the Averages have been followed by collapsing markets, far too many to argue with Rhea's conclusions to the effect that when the two Averages disagree, the market is under distribution.



Next, we come to volume. For the first time in seven months, 20 million shares-and-over days are appearing on the NYSE. But this time there is a difference. The majority of stocks are now far below their March-April, 1972 highs. Thus, today's huge volume is not moving the majority of stocks to new highs for the year, it is simply churning stocks up to levels well below the area where the last 20 million share days occurred. And it is well worth remembering that the huge-volume days of March-April, 1972, accompanied the peak for the A-D ratio. In other words, heavy volume and 20 million share days tend to mark the end of advances, not the beginning.

A friend came into the office today (an investment advisor) and said, "Dick, try this interesting experiment. Open Barron's and blindly put your finger down anywhere on the quote pages for the NYSE, the Amex or NASDAQ. Take the price of the stock you touch and compare that price with the price of April, 1972." I did it in two sessions of 10 stocks each. The results startled me. Of the 20 stocks I touched, 13 were below their April highs, some by 30% to 67%. The 1972 damage was really more widespread and severe than I had realized (readers might try this test themselves).

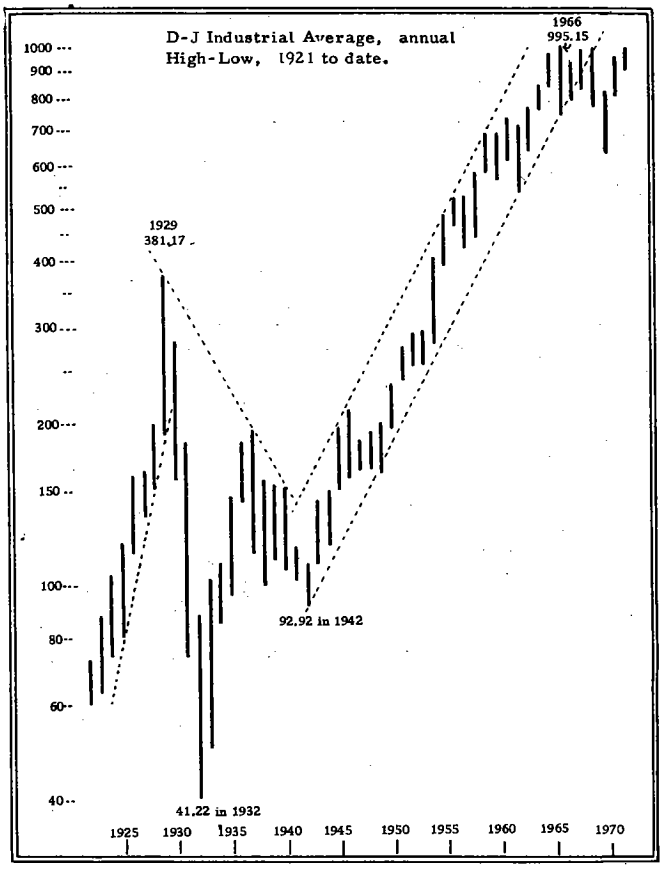
That experiment dealt with a random selection of stocks on any exchange. But how about the blue-chip Dow Industrials, the Average which commands the real attention of the public? On page 3 I show a chart of the D-J Industrials in the form of annual high-low ranges going back to 1922. The chart is constructed to semi-logarithmic (ratio) scale, so that all movements are shown in percentages (thus a rise from 200 to 400 consumes the exact vertical distance as a rise from 350 to 700).

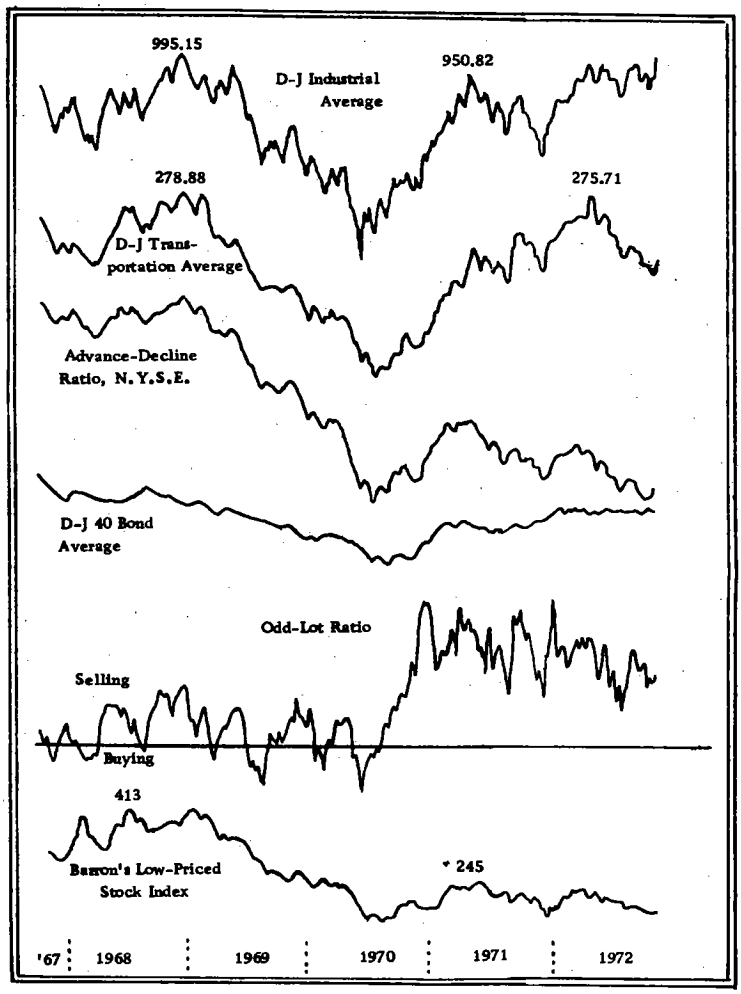
Note that the long, rising channel which began in 1942 was broken in 1969. This meant that the upward rate of growth which had held for 27 years was reversed in 1969. Since '69, all fluctuations in the Dow have held under the channel. I believe that the main reason why the Dow has not crashed (even though many stocks did during 1969-70) was the furious Government inflation efforts, efforts which obviously aided the big Dow stocks far more than the great majority of non-Dow stocks which were less able to cope with the problems of the 1970's.

Despite this, here in 1972 we find the Industrial Average once again "hanging on," tugging at the old 1966 peak of 995.15 as it has in five of the six years since 1966 (1969 was the only year which saw the Dow hold far below the 1966 peak). Will the Dow finally burst through the 995.15 barrier during 1972? It matters little, since the strain, the divergences, the broken trendlines, the collapse of the majority of stocks, the technical damage, indicates that the upside action since 1966 has been merely a holding action, an inflation-inspired "hanging on" until the primary bear market exerts its full, relentless force again.

The second chart on page 3 provides a perspective from the standpoint of six indicators. This chart was constructed from graphs provided by Comparative Market Indicators, Box 1447, Bellevue, WA 98009. Here we can study five years of the technical hodge-podge which has finally resulted in today's schizophrenic market. At the top of the chart are the weekly D-J Industrial plottings. With the Dow now just under its 1966 high, it is notable that the Transports would have to mount a major advance to catch up (and remember, Transports led the entire rise from 1952 to 1966 and again from 1970 to 1971).

The chart shows the dramatic breakdown which has occurred in the A-D ratio and the total lack of progress since the 1970 bottom. Of interest is the rise in the D-J 40-Bond Average from 1970 through 1971. I am indebted to Mr. C. Coleman Petty (a veteran reader of these reports) for informing me in a letter received October 30, that "This year the 40-Bond Average to date has ranged from 73.41 to 74.55, a difference of only 1.14 points or a percentage change of only 1.53%, the smallest in history..." Mr. Petty, an acute student of markets, is of the opinion that "we are in for another big spill in the bond market."





Turning to the odd-lot ratio on the chart, it is obvious that the odd-lot public has been on the "sell" side of the market since 1970. There seems to be a slight trend towards less selling during 1972. Finally, the speculative Low-Priced Index collapsed during 1969-70 and sustained only the feeblest recovery during 1971. At present, the Low-Priced Index is near its 1970 low again. If the public or anyone else has an appetite for low-priced issues, it is not apparent from the profile of this index.

MUTUAL FUNDS, PENSION FUNDS: For many months we have been witness to the unusual sight of net redemptions over purchases in the mutual fund industry. It's as if the public has suddenly become disenchanted with the entire Wall Street and "fund street" road to riches.

Sensing the implications of this mass exit, the funds have been trying to build up a bit of cash, and the latest figures show fund cash assets at 5.9% (pitifully small by most standards, but "large" by fund standards).

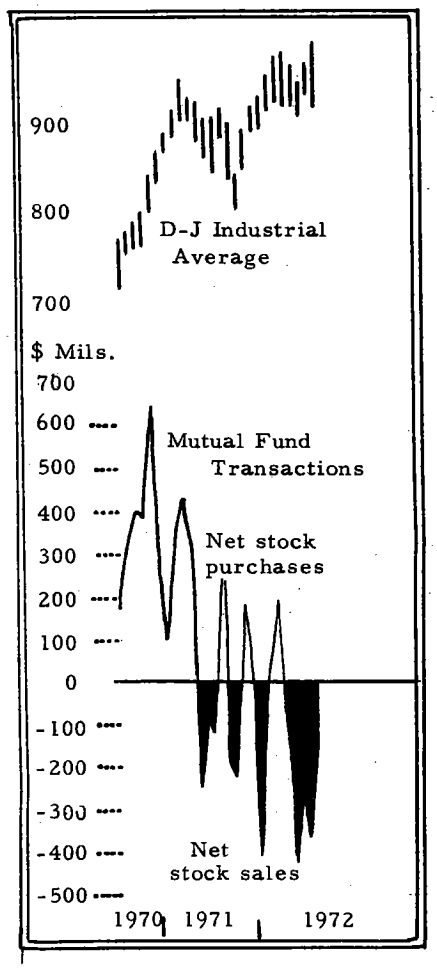
The interesting question is how will all this affect the stock picture? The funds need cash for two reasons, (1) simply to hedge against a stock market decline or to buy stocks near the bottom of a decline, and (2) to pay off stockholders who may want to redeem their shares. In order to raise cash, the funds must sell assets, most of which are in common stocks.

Over the past four months about $1 billion in common stocks have been sold. To put the picture in perspective, at this rate it would take about 17 years for the $50 billion mutual fund industry to disappear (an extreme example, to be sure). But it does indicate the high rate of net sales of common stocks by the funds.

I have drawn the accompanying chart (see page 4) to illustrate the trend of mutual fund sales of common stocks. As we can see, the situation of large net purchases of common stocks which existed in mid-1970 has now reversed to a situation of large net sales of common stocks. Thus, the funds are exerting a steady pressure on the stock market.

Note: This chart should not be confused with the commonly seen charts showing mutual fund sales and redemptions or the charts showing net mutual fund sales minus redemptions. The chart in this report traces mutual fund net purchases minus sales of common stock. This is the chart which shows the effect of mutual fund activities on the stock market.

So much for the mutual funds. All this has been outweighed by the recent massive purchases of common stocks by the pension plans. Caught late in the "great stock market game," many of the pension funds have loaded up with common stocks over the past few years, in many cases buying up to the maximum allowed by law. This huge buying by the pension funds has been one of the recent mainstays of this market.



The August 28 issue of Barron's carried an article about the pension funds entitled "Sure as Death and Taxes." That article dealt with the thesis that corporations have in a great many cases not allowed the public to see what was happening in regards to pension handling of pension funds. Barron's sited the example of National Steel, whose pension fund costs for 1971 amounted to 71% of earnings and 64% of dividends. The general idea in the article was that pension funds are not being funded, payments are put off, and in most cases the costly effect of corporate pension plan operations appears as footnotes in the annual company report.

I believe the whole pension fund question is going to surface next year. In his recent (Oct. 25) report, Eliot Janeway states the pension fund reform is a top priority on labor's legislation list for 1973. Says Janeway, "Putting all pension on a mandatory funded basis is the incidental feature of labor's pension fund reform program. The triple play it would start would (1) inflate the cost of corporate contribution; (2) deflate corporate earnings; and (3) switch pension fund investments to high-yielding securities. The threat to the 1973 stock market from the pressure to put pension funds on a funded basis is more ominous than that from inflation -- and that's going some."

GOLD: Last week for the umpteenth time, a subscriber sent me a report stating that gold was part of an "international conspiracy," and that it was going out of style (the "Conspirators" are going to put it in disrepute, and nobody is going to want it). As a matter of fact, that's exactly what the US Government has been trying to do for years, now that the US has become the world's largest paper manufacturer (International Paper and St. Regis, watch out).

So a few days ago I decided to make a montage (page 5) from a few of the recent hidden and not-so-hidden items pertaining to money and gold which I had seen in various papers and reports. The price of gold chart is courtesy of the Bank Credit Analyst, the "buying power" tabulations are courtesy of First National City Banks (NY).

Those who are aware of the "energy crisis," also know that along with it goes a new balance-of-payments crisis. It is estimated that by the middle of this decade, the current mild but growing shortage of gas, will become critical. According to Money & Credit (787 Fifth Ave., NYC 10022) "The capital costs to develop and expand new and existing resources (of oil and gas) will exceed $300 billion for the balance of this decade." They also state, "Importing of oil now to the end of the decade and making reasonable price assumptions could produce a mammoth petroleum trade deficit. Estimates range from $12 billion to $20 billion a year." In the face of figures like that, the pressure for a massive rise in the gold price becomes increasingly irresistable.

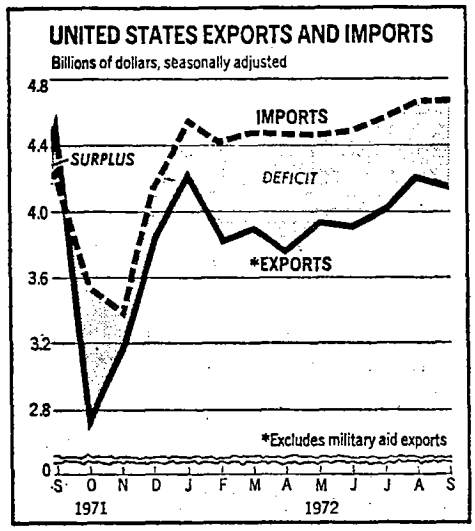
Now we all know that the US is claiming that gold is a "barbaric relic" and that the official US price for gold is $38 per ounce. But this is strange, after the US has sold over $10 bil. of gold at $35 per ounce, what's this little print-out from Reuters? It says that the US is what...buying gold from mother Russia at an average price of $65.87? How can that be? Could Reuters have the story wrong?

What are we really to believe? Should we believe the official statements or the official action? There is the old saying, "Actions speak louder than words." So with inflation rampant, with the US denouncing gold out of one side of its mouth and buying it (at high prices) out of the other, with our budget and balance-of-payments deficits running wild, it's hard to have faith in paper, regardless of who says what it is worth. And I haven't seen any signs of change yet (maybe after election Mr. Nixon will announce that he has switched back to non-Keynesian status again).

STOCKS: Response to the new technical approach to the Dow stocks has been excellent and most encouraging. The Dow stocks, as gauged by (1) position above or below the 10-wk moving average, (2) on-balance-volume or cumulative upside-downside volume, (3) relative strength of the stock against a broad average, (4) short interest if one exists in the stock, and (5) the direction of odd-lot activity, are given a weekly rating of zero to 5 or zero technical strength to peak technical strength.

Currently, in the strong 3 category are Chrysler, Int. Paper, Proctor, Sears, Texaco and United Aircraft. Jumping to 4 this week is Anaconda (the only other 4 is Stand. of Calif.). The single 5 is Amer. Telephone (T is rated 5 because it has a short interest, and its short interest is rising).

U.S. Export Volume Falls As Imports Set a Record



The New York Times/Oct. 27, 1972

Special to The New York Times

WASHINGTON, Oct. 26 — United States merchandise exports declined in September while imports rose to another high, the Commerce Depart- trade with other countries was in deficit by $1.67-billion sonally adjusted, smaller than billion

What happened to the world's buying power

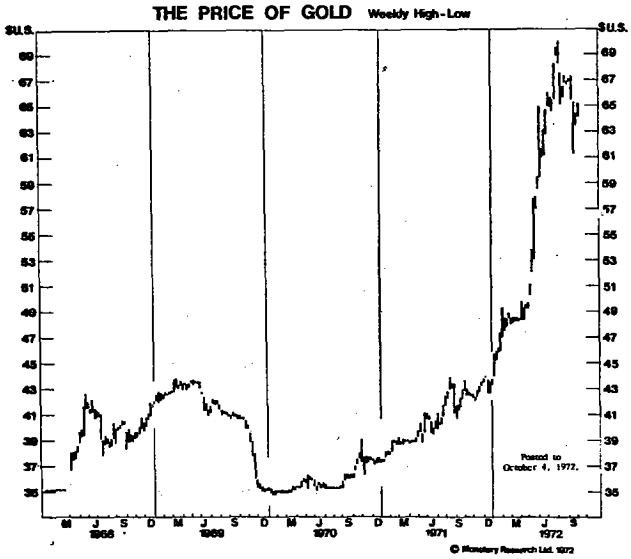
	Industrialized countries: Indexes of value of money (1961=100) 1966	1971	Rates of depreciation of money '61-'71*	'66-'71*	'72†		Less-developed countries: Indexes of value of money (1961=100) 1966	1971	Rates of depreciation of money '61-'71*	'66-'71*	'72†
United States	92	74	3.0	4.3	3.2	Singapore	94	88	1.2	1.2	1.1
Greece	89	80	2.2	2.2	3.8	Indonesia	1	‡	56.6	33.2	1.3
Japan	74	56	5.6	5.4	4.1	Costa Rica	92	79	2.3	3.0	2.2
Luxembourg	87	74	2.9	3.2	4.4	Venezuela	94	86	1.5	1.7	3.0
Canada	90	75	2.8	3.6	4.4	Thailand	91	81	2.1	2.2	3.4
Italy	79	66	4.0	3.4	4.5	China (Taiwan)	94	77	2.6	4.0	3.7
Belgium	85	72	3.3	3.4	4.9	Mexico	89	76	2.7	3.2	4.3
Germany	86	74	2.9	2.8	5.2	Jamaica	91	67	3.9	5.9	4.8
France	83	65	4.2	4.7	5.3	Morocco	85	78	2.4	1.6	4.9
Sweden	80	64	4.4	4.5	5.3	India	69	55	5.8	5.8	5.0
Austria	84	70	3.6	3.7	5.5	Pakistan	83	68	3.8	3.8	5.9
Iceland	56	32	10.7	10.6	5.8	Ecuador	83	63	4.5	5.3	6.5
South Africa	88	73	3.1	3.8	5.9	Iran	94	83	1.8	2.2	6.5
Denmark	76	55	5.7	6.0	6.0	Paraguay	75	69	3.6	1.7	8.4
Switzerland	83	69	3.7	3.7	6.1	Peru	62	40	8.8	8.5	8.4
Norway	81	62	4.7	5.2	6.2	Nigeria	83	61	4.9	6.2	9.5
Australia	91	76	2.7	3.6	6.5	S. Korea	48	28	12.0	10.2	9.8
United Kingdom	84	64	4.4	5.4	6.7	Colombia	51	35	10.1	7.4	11.1
Finland	76	59	5.1	4.9	6.8	Israel	70	55	5.7	4.6	11.8
New Zealand	87	64	4.4	6.0	7.3	Brazil	9	3	29.6	19.0	16.2
Spain	68	52	6.4	5.2	7.5	S. Vietnam	47	13	18.5	22.5	16.9
Netherlands	80	63	4.6	4.9	7.7	Turkey	81	49	6.8	9.3	17.6
Ireland	81	59	5.1	6.1	8.0	Philippines	76	51	6.6	7.8	18.5
Portugal	85	59	5.2	7.1	11.7	Chile	26	8	21.9	20.3	25.3
Yugoslavia	47	29	11.5	8.8	13.3	Argentina	30	12	18.9	16.5	34.3

*Compounded annually. † Based on average of monthly data available for 1972 compared with corresponding period of 1971. ‡Less than one.

Hitachi's U.S. unit plans to begin assembling color television sets in America early next year, making it the latest Japanese TV maker to do so.
(Story on Page 12)

Britain's pound continued to slump in international money markets yesterday, closing in London at $2.3609. That is a drop of 9.4% since the currency was floated last June, with the current decline attributed to nervousness about sterling's ultimate pegged rate.
(Story on Page 6)

THE PRICE OF GOLD Weekly High-Low



RECORD SALES OF SOVIET GOLD TO U.S. REPORTED FOR LAST NINE MONTHS

WASHINGTON, OCT 30 - THE SOVIET UNION HAS MADE THE LARGEST RECORDED SALES OF GOLD TO THE U.S. DURING THE PAST NINE MONTHS, TREASURY SOURCES SAID HERE.

UP TO THE END OF SEPTEMBER U.S. CONSUMERS BOUGHT 245,000 OUNCES OF SOVIET GOLD FOR INDUSTRIAL AND ARTISTIC USE AT A VALUE OF 16.14 MLN DLRS GIVING AN AVERAGE PRICE OF 65.87 DLRS PER OUNCE.

THE WALL STREET JOURNAL, Thursday, November 2, 1972

"One possibility is that the overwhelming economic supremacy of the United States will collapse while the positions of the European Community and Japan will be elevated, causing big changes in the balance of power which may involve risks of giving rise to various political and economic confrontations."

—JAPAN ECONOMIC RESEARCH CENTER, MARCH, 1972.

Treasury Gives U.S. Brokers Green Light To Serve Winnipeg Gold Futures Market

A WALL STREET JOURNAL *News Roundup*

The U.S. Treasury gave American companies a green light to provide brokerage service, in the gold-futures market planned by the Winnipeg Commodity Excha

U.S. companies and t ies that are members of abroad "ma

cean Grain Co., Winnipeg, said a trading contract for the precious metal will consist of 400 ounces of gold grading 99.5% purity. He said there would be a $2 per oun he n

European Monetary Fund will be established next April 1, Common Market heads of state or government agreed at the start of their two-day summit meeting. Only the date was at issue, although the session also directed finance ministers to report on boosting the fund's short-term credits and a possible pooling of central bank reserves in it, and to work out a concerted inflation-fighting plan.
(Story on Page 5)

Consumer prices last month soared at a 6% seasonally adjusted annual rate, the worst showing for the Labor Department's politically sensitive index since February. September's adjusted 0.5% spurt was more than twice August's 0.2% rise, with short fruit and vegetable supplies and sharply higher apparel prices blamed. It was a setback for the administration.
(Story on Page 3)

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Stocks rated zero are Alcoa, Bethlehem, Johns Manville, Owens Illinois. This week there were 10 Dow stocks rated 3 to 5, 14 rated zero or one.

I have included 3 charts, Johns Manville (JM) which is weak with a zero rating and Anaconda (A) and Stand. of Calif (SD) both with strong 4 ratings. Note on JM that the stock typically rallies to its moving average, then turns down again. OBV is collapsing and relative strength (RS) is looking poor. The odd-lot public, evidently feeling that JM is a "buy" as it declines, is purchasing almost as many shares as they are selling, a negative technical factor.

The new "strong" candidate this week is A, shown here moving above its moving average (MA). OBV is exceptionally strong, RS seems ready to move to a new high and odd-lotters are selling the stock at the rate of 500 shares for every 100 purchases (thus the odd-lot index on the chart is at 500). As A rises off its low, the public (which has taken a horrible beating in A) obviously senses that this is a golden opportunity to sell. The public will probably be wrong.

Standard of Calif. (SD) has been a shining star with all technical indices in gear on the upside. SD has the strongest odd-lot pattern (a rise in the ratio towards selling) of any Dow stock, and the only thing that can be said against SD is that it has moved so far above its MA that it might be due for a correction. Oddly, SD appears considerably stronger than the other two Dow oils, Jersey and Texaco.

A subscriber asks, "What about buying the 4 and 5 rated Dow stocks and shorting the zero's?" My answer is that I am keeping data on this but cannot give an answer now. I have kept data on buying the 3, 4 and 5 rated stocks in sideways and up markets and results so far are good. But more time is needed for the answers.